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SUPREME COURT, U. S.

No. 1098

IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

Potomac Cooperators, Inc. and
Alexander Hassan,

Petitioners,

v.

American Security & Trust Company,
Trustee in Reorganization of
Parkwood, Inc.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Potomac Cooperators, Inc. and Alexander Hassan petition for a Writ of Certiorari to review the Order of the United States Court of Appeals for the District of Columbia Circuit entered in this cause on December 2, 1968.

OPINION BELOW

The Order of the Court of Appeals is an unreported per curiam Order. (Appendix)

JURISDICTION

The Court of Appeals Order was entered on December 2, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The District Court had jurisdiction under 11 U.S.C. § 11(a)(2).

QUESTION PRESENTED

Whether a Court of Bankruptcy is powerless to apply the doctrine of abstention and to remit fundamental first impression questions of state law to a state court merely because the question arises in proceedings pursuant to a Bankruptcy Trustee's objection to a proof of claim under Section 196 of the Chandler Act.

STATUTE INVOLVED

Section 196 of the Chandler Act, 11 U.S.C., § 596, 52 Stat. 893 provides as follows:

> "After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the Court."

STATEMENT

This is a proceeding in the United States District Court sitting as a Court of Bankruptcy for the reorganization of Parkwood, Incorporated and other related corporations under Chapter X of the Bankruptcy Act.

Petitioners each filed timely proofs of claim as secured creditors of Parkwood, Inc.[1] Petitioner Potomac is the

[1] Petitioner Hassan's proof of claim was also filed against a second tier subsidiary of Parkwood, Franconia Industrial Park, Inc. (R. par. 1, Ex. 2).

holder of a deferred purchase money deed of trust on property in Maryland which it sold to Parkwood and Petitioner Hassan is the holder of a deferred purchase Money deed of trust on property in Virginia which he sold to Parkwood. (R. par. 1, Ex. 1).[2]

On May 1, 1968 the Trustee filed its objections to both Petitioners' claims. It alleged that under Maryland law an affidavit of true and bona fide consideration was required to be affixed to Petitioner Potomac's deed of trust and that under Maryland law the absence of an affidavit rendered the deed void as to a Trustee in Bankruptcy. The Trustee alleged that Petitioner Hassan's deed of trust was notarized by an improper party, one of the two trustees named in the deed, and is considered void and unrecorded under Virginia law. (R. par. 1, Ex. 3).

Both Petitioners promptly filed on May 14, 1968 Petitions for an Order of Abstention asking the Referee to remit these basic and unsettled state law questions raised by the Trustee to state courts to allow those courts the opportunity to pass on the first impression questions involved. (R. par. 2, Ex. 4).

The Trustee opposed the Petitions in the District Court principally on the basis that "This Court does not have the authority to 'abstain'." (R. par. 2, Ex. 5, p. 3). The Trustee's position was based on the language of Section 196 of the Chandler Act and the Trustee contended "This Section requires the Court to exercise its jurisdiction and removes from it, with respect to objections to proofs of claim, the discretion allowed Federal Courts in other circumstances." (R. par. 2, Ex. 5, p. 3).

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[2] The parties filed an Agreed Statement of Record on Appeal consisting of 7 paragraphs to which 13 Exhibits are attached. Citations to "R" refer to the Agreed Statement. Citations to the documents filed in the Court of Appeals will refer to the document by title.

The Referee denied the Petition. The District Court affirmed. (R. pars. 3 and 4).

Petitioners appealed to the Court of Appeals and the Trustee filed a Motion for Summary Affirmance which was granted by the Court of Appeals on December 2, 1968. (Appendix).

REASONS FOR GRANTING THE WRIT

This case presents a novel question of major significance in the interpretation of the Bankruptcy Act which has not been but should be decided by this Court.

The Court of Appeals granted summary affirmance in response to a contention that a Bankruptcy Court lacks the power to order abstention and to permit resolution of undecided state law questions by state courts.

The Trustee's position that a Bankruptcy Court has no power to abstain is apparently based solely on the use of the word "shall" in Section 196 of the Bankruptcy Act. It could cite to the Court of Appeals no authority either primary or secondary, nor could it offer any legislative history to support its challenge to this Court's doctrine of abstention. The Trustee contended only that Section 196 absolutely forbids a federal court to remit to a state court a state law question if it relates to a Trustee's objection to a proof of claim simply because Section 196 provides that objections to proofs of claim "shall be heard and summarily determined by the Court." 11 U.S.C. § 596.

The Trustee argued that "Section 196 prevents the Bankruptcy Court from declining jurisdiction."[3] However, abstention is not a refusal or abdication of jurisdiction. Jurisdiction to allow or disallow a proof of claim remains at all

[3] Memorandum in Support of Appellee's Motion for Summary Affirmance, p. 4.

times with the Bankruptcy Court and only the state law questions are decided by the state court.

Rather than a jurisdictional contest, the doctrine of abstention has long been an important judicial prerogative and an essential tool of comity between federal and state courts. This Court long ago, in *Thompson* v. *Magnolia Petroleum Company*, 309 U.S. 478 (1940) reversed a lower court's refusal to permit abstention in a bankruptcy case, stating that abstention can and should be granted in appropriate cases by a Bankruptcy Court. See also *Ex Parte Baldwin*, 291 U.S. 610 (1934).

In *Thompson* this Court recognized the Bankruptcy Court's exclusive control over the bankrupt estate, but ruled that despite that exclusive control "the exercise of that control may, where the interests of the estate and parties will best be served, lead the bankruptcy court to consent to submission to state courts of particular controversies involving unsettled questions of state property law and arising in the course of bankruptcy administration." 309 U.S. at 483.

The Court of Appeals' Order of December 2, 1968 is the only ruling to Petitioner's knowledge holding the above doctrine inapplicable to bankruptcy proceedings relating to objections to a proof of claim.

By contrast, this Court has often held in bankruptcy cases that the failure to permit abstention under appropriate circumstances is an abuse of discretion. For example, the failure of a Bankruptcy Court to permit a state court to decide title to oil in the Trustee's possession was held an abuse of discretion and abstention was ordered by this Court in *Texas* v. *Donoghue*, 302 U.S. 284 (1937). The failure of a Bankruptcy Court to abstain to permit a separate plenary suit for damages against an insured bank-

rupt was also held an abuse of discretion in *Foust* v. *Munson Steamship Lines*, 299 U.S. 79 (1936).

Here also the Bankruptcy Court's refusal to remit the case to the state court for decision constituted an abuse of discretion and the Court of Appeals' "summary affirmance" constitutes a hastily considered endorsement of the proposition that a federal court is powerless to apply the abstention doctrine to a question arising in the course of a Trustee's objection to a proof of claim.

Although the Trustee urged alternative grounds for its opposition to abstention claiming that, in any event, the state law questions did not justify abstention, the Trustee did not brief or argue the status of state law before the Bankruptcy Court or the Court of Appeals. Such questions, of course, go to the merits of the appeal, but the Court of Appeals responded to the Trustee's claim that the court lacked power to order abstention and dismissed the appeal by summary affirmance on Motion of the Trustee without permitting the filing of Briefs on the merits. The Court of Appeals thus failed to consider the abuse of discretion by the Bankruptcy Court.

The Bankruptcy Court was presented with an objection by the Trustee to the secured status of Petitioner Potomac on the sole ground that its deferred purchase money deed of trust, which was in all other respects validly and properly recorded, was void as to the Trustee because it did not have affixed to it an affidavit that the consideration recited in the deed was true and bonafide.[4]

There is no suggestion by the Trustee that the consideration was not in fact true and bona fide as, indeed, there could not be since the deed was given to Petitioner to

[4] The asserted statutory requirement for the affidavit is Art. 21, § 30, Maryland Code Anno. (1957).

secure the unpaid balance of the purchase price owed by Parkwood to Petitioner on the arm's length sale to Parkwood of Petitioner's interest in property in Maryland. The Trustee relies solely on an alleged formalistic defect in the Deed which would not have invalidated the deed as to Parkwood itself.

The unsettled questions and the questions of first impression under state land law which require abstention in this case are numerous. The Trustee itself has claimed that the federal court is not bound by the decision in the most recent case decided by the Maryland Court of Appeals (*Pagenhardt* v. *Walsh*, 250 Md. 333, 243 A. 2d. 494, decided June 28, 1968) where a deed of trust lacking the affidavit was held good as against a bankruptcy trustee and all others except certain listed creditors who had no actual notice of the deed.

Moreover, a Maryland curative statute (Art. 21, § 99, Md. Code Anno. (1957)) which validates deeds of trust containing defects in their form has yet to be construed in a case involving the absence of an affidavit of consideration. Here, also, the Trustee contends that the statute is not applicable, but since the question is one of first impression, cites no Maryland authority.

Any decision on the applicability of this statute or the effect of its operation potentially affects every deed, mortgage, deed of trust and certificate on record in the State of Maryland.

Such fundamental questions of state land law[5] involv-

[5] Additional unsettled questions under Maryland law which this case presents are: whether an affidavit is required to be attached to deferred purchase money deeds of trust such as Potomac's or only to deeds of trust given to a third party to secure a loan; and whether any defect in the deed of trust was cured when Potomac re-recorded the deed of trust with an affidavit. Neither of these questions appears to have been decided by the Maryland courts.

ing a largely untested Maryland statute should, on grounds of comity, be decided by the state courts rather than by a federal court which can only predict the law of the state. *Railroad Commission* v. *Pullman Company*, 312 U.S. 496 (1941).

The Trustee's objection to Petitioner Hassan's proof of claim likewise alleges a highly formalistic defect. It challenges the validity of Petitioner Hassan's deferred purchase money deed of trust on the grounds that the notary who witnessed Parkwood's signature on the deed of trust was also named as one of the two trustees in the deed. It argues that the notary, therefore, had an interest in the deed and his notarization was ineffective and the recordation of the deed is thus a nullity. Though it relates to formalities, the resolution of this issue raises serious questions under Virginia's common law doctrine of instantaneous seisin[6] and questions whose resolution will determine the validity or invalidity of numerous Virginia deeds of trust.

Also presented by Petitioner Hassan's case is the question whether the existence of a co-trustee or the right to substitute trustees eliminates the notarization problem and whether the Virginia curative statute (Section 55-125, Virginia Code Anno. (1950)) cures a defect of this sort. These, too, are seriously disputed and unsettled questions of Virginia law.

The abstention requests of both Petitioners present a significant common question to this Court because of the hypertechnical character of the Trustee's objections to their

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[6] The Virginia Supreme Court has held that even an unrecorded deferred purchase money deed of trust (to which the Trustee likens Petitioner Hassan's recorded deed of trust) is superior in Virginia to a subsequent judgment creditor and a subsequent mortgage recorded prior to the recording of the deed of trust under Virginia's doctrine of transitory seisin. *Charlottesville Hardware Co., Inc.* v. *Perkins*, 86 S.E. 869 (Va. 1915).

validly recorded deeds of trust. There is no question in both cases that the deeds are valid in all other respects. Nor is there any doubt that the bankrupt itself could not have challenged the deeds. They are clearly valid as between the parties. An adverse decision to Petitioners' claims will deprive them of their property on the basis of technicalities having no relation to the validity of the claim, the validity of the deed, or its effectiveness as recorded to impart actual notice to others. Under these circumstances such a decision would deprive Petitioners of their property without due process of law and would unreasonably abridge their freedom of contract.

Such constitutional questions may well be avoided by the construction of the state statutes as contended by these Petitioners. Abstention serves a valid purpose in permiting state courts to have the opportunity to construe basic and far reaching state statutes in such a way as to eliminate any constitutional infirmity. *Harrison* v. *N.A.A.C.P.*, 360 U.S. 170 (1959).

And contrary to the Trustee's own interest, federal courts have no need to protect an interest of the federal sovereign in questions such as those presented here. But the states involved have a very critical interest in forging the law of land titles and recordation in which each decision may affect rights in and title to the land of that state and may inadvertently revolutionize real estate practices in the state.

For a federal court to deny the states the right to rule on questions such as these results in the "needless friction"[7] abstention was created to avoid.

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[7] See *Louisiana Power and Light Company* v. *Thidodaux City*, 360 U.S. 25 (1959), dissenting opinion.

CONCLUSION

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 22,390 — September Term, 1968
In the Matter of — Bankruptcy 46-66
Franconia Industrial Park, Inc.,
Appellant.

No. 22,391
In the Matter of — Bankruptcy 39-66
Parkwood, Inc.,
Appellant.

No. 22,392
In the Matter of Parkwood, — Bankruptcy 39-66
Inc., Franconia Industrial Park, Inc.,
Appellants.

Before: Bazelon, Chief Judge; and Leventhal and Robinson.

ORDER

These causes came on for consideration on appellee's motion for summary affirmance and the Court heard argument of counsel.

Upon consideration thereof, it is

ORDERED by the Court that appellee's aforesaid motion be granted and the judgments of the District Court appealed from herein are hereby affirmed.

Per Curiam.